



Testimony of Charles Bell, Programs Director, Consumers Union

Public Health Committee Public Hearing

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SB 460 An Act Concerning Hospital Conversions and Other Matters Affecting Hospitals

**HB 5571 An Act Concerning Certificate of Need Requirements,
Hospital Conversions and Medical Foundations**

Good afternoon, Senator Gerratana, Representative Johnson, and members of the Public Health Committee. My name is Charles Bell and I am Programs Director for External Relations & Advocacy at Consumers Union, the nonprofit publisher of Consumer Reports, based in Yonkers, NY. Since the 1980s, our organization has been involved in state and national work to monitor conversions of nonprofit health plans and hospitals to for-profit companies.

A key point that we always emphasize about nonprofit health conversions is that the decision to convert a nonprofit, charitable health care corporation to for-profit operation is not just a technical change in corporate structure. It is a legal, policy and community decision about how to organize and arrange for health care services in a community, state or region. For that reason, it requires full disclosure, transparency and community participation similar to other decisions that affect the quality, affordability and accessibility of health care services.

In our work, we have seen many, many health care restructuring transactions and conversions that moved too rapidly, sometimes under the radar of regulators and legislators. We have seen many nonprofits in other states converted by corporate insiders, who privatized and pocketed the charitable assets owned by the health plans and hospitals. In some cases, those assets – which had established by charitable and religious leaders, and built up over many years through contributions of money, volunteer labor, community support and favorable tax treatment -- were not formally valued and they were lost to the community. In other cases, we see the consequences of health care services that are precipitously withdrawn and discontinued, because the policy framework and review process does not provide for adequate public disclosure and discussion of potential changes in health services after conversion or restructuring.

The legal framework governing nonprofit conversions needs to ensure that citizens and communities have meaningful participation in decisions that affect the health care services they will have access to, now and the future. Nonprofit hospitals serve many diverse types of patients in communities, including the young and the old, working class and middle class people, uninsured, people with chronic illnesses and disabilities, men and women, people with urgent care needs. Nonprofit hospitals are also economic anchors in many communities. They help support large and small business growth and expansion, and they provide incomes, career paths and livelihoods for health care workers. So it should be clear that there are many citizens and residents who are stakeholders

to these transactions, who are entitled to information to understand how services might be affected, changed or enhanced through a conversion proposal.

The threshold question for any conversion or restructuring transaction is whether it is in the public interest. It is often difficult to assess the merits of conversion proposals, because not enough information is provided to the public at one time and in one place by the converting entity. Also, because the organization is fundamentally transforming itself from a charitable, nonprofit corporation, dedicated to a social mission of providing affordable, accessible quality health care, to a for-profit corporation, with a commercial mandate to earn profits for owners and investors, there are many special considerations that come into play. By changing to the new for-profit corporate structure, previous obligations to pursue social mission, public goods and community benefits are eliminated. New operating needs required by the for-profit corporate structure come into play, to meet bottom lines and pay profits to owners. The new profit requirements generate intense new pressures to achieve “operating efficiencies,” rightsizing and outsourcing, economies of scale, geographic expansion, and further merger and consolidation, in addition to new financial needs for marketing and administrative costs, payment of taxes, IT investment, and executive compensation.

These new for-profit requirements and operating practices are very much worth considering and anticipating, because the new profit orientation may unleash and accelerate further pressures for change or restructuring that spillover to affect other nearby hospitals and health organizations in the state or region, and encourage additional conversion and consolidation.

In reviewing a hospital conversion transaction, ideally you would want to know 3 things: 1) how the new for-profit will constitute itself, operate and behave 2) what type of charitable foundation or set-aside will take place, what is this new entity’s mission and who will direct its operations; and 3) what conditions to the conversion have been agreed upon, or regulatory requirements established, such that important public needs and requirements will be protected or mitigated. Those 3 factors taken together would be extremely important for the community to know, and for the regulator to know, to conduct an effective assessment of whether the conversion transaction is in the public interest.

Given how much is at stake, it makes very good sense to require presentation and disclosure of detailed information about the nature and implications of proposed conversions of hospitals to for-profit operation, as proposed in these 2 bills. Also, policymakers may want to be extremely careful or selective about how many for-profit conversions you choose to permit, if any, rather than opening the floodgates to this practice. We look forward to the opportunity to submit additional comments about the specific bill language for these two bills, and the policy issues relating to for-profit hospital conversions.

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Issues Raised When a Nonprofit Hospital or Health Insurer Proposes to Convert to For-Profit Status

When a nonprofit hospital or health insurer proposes to convert to for-profit status, consumers should be wary. Unlike nonprofits, which are required by law to serve the community, for-profits answer only to private investors or shareholders. Regulators should critically examine any conversion proposal to ensure that it is in the public interest. Following is a summary of some of the issues raised when a nonprofit hospital or health insurer proposes to convert to for-profit status.

Health Impact: State regulators should not approve a conversion unless it will preserve or improve the availability, affordability and quality of health care in the community. Will the conversion result in a reduction in health services, like reproductive care or emergency services? Will charity care levels be cut? Will any hospitals close? Often times, when a hospital chain buys two hospitals in the same community, it will close the less-profitable hospital shortly after the deal is approved by regulators. If the conversion involves a nonprofit health insurer, will it raise premiums? Will the conversion increase the number of uninsured in the community? Regulators should commission an independent health impact study to answer these questions, and only approve a conversion where the access to affordable quality health care will be maintained or expanded.

An Open and Fair Public Process: Regulators should hold public hearings throughout the service area. Community groups asserting a “significant interest” in the transaction should be granted intervener status.

Anti-Trust: The conversion should not reduce competition. Regulators should refer cases involving potential anti-trust violations to the Federal Trade Commission.

Conflicts of Interest: Regulators must not approve a conversion if there were any conflicts of interest leading to the decision to convert.

Fiduciary Duty/Due Diligence/Private Inurement: The board has a fiduciary duty to act in the best interests of the nonprofit hospital or health insurer, and to maintain the nonprofit mission unless it has become impossible, impractical or unlawful. Did they exercise “due diligence” in deciding to convert and/or in selecting a buyer? Is anyone privately benefiting from the deal?

Fair Market Value: Under the law, the assets of any nonprofit essentially belong to the community. If the nonprofit closes its doors, or converts to a for-profit, all of the assets of the nonprofit must continue to serve its charitable mission. Regulators should commission an independent valuation to ensure that the community receives fair market value for the nonprofit.

Creation of an Independent Foundation: If the conversion is approved, the full value of the charitable assets must go to an independent foundation to continue to serve the health needs of the community. This foundation should be entirely free of influence from the former nonprofit or from the successor for-profit. The mission, structure and governance of this foundation should be determined by the community.

Is it in the public interest to permit for-profit hospital conversions?

According to Bradford Gray of the Urban Institute, at least 210 studies have been done comparing the performance of nonprofit and for-profit hospitals, nursing homes or HMOs. In studies of cost, quality, and access the most common finding is that nonprofits perform better.¹ Many studies have found that nonprofit hospitals tend to be less expensive for patients, and that they also deliver more in terms of community benefits and charitable services. But the comparative performance is not the only issue. The presence of for-profit can change the behavior of nonprofits in a metro area or region, so that you get less charity care in markets with greater for-profit presence. Further the presence of for-profits may have a cumulative effect; markets with more for-profit hospitals tend to have higher costs.

Nonprofit status may also have some other advantages, as Gray also points out. There is an issue of “trustworthiness.” Patients have expectations that health care organizations will behave in ways that depart from profit maximization. Health care has asymmetries of information between buyer and seller that makes payers and patients vulnerable to exploitation. When we consumers seek treatment, we hope the treatment we get is not being skewed or compromised by financial rent-seeking; we trust that the provider is operating in our interest. The nonprofit form provides some assurance and safeguards against the tendency to exploit that vulnerability. Also, tax exemptions may provide a useful policy lever to encourage public-minded behavior. Finally, nonprofits are less prone to control by national organizations, as opposed to national companies that must answer to stockholders and may have less affinity, loyalty or enduring presence in a state or region.

¹ Schlesinger, M. Gray, BH. “Nonprofit Organizations and Health Care: Some Paradoxes of Persistent Scrutiny” in Walter W. Powell and Richard Steinberg, eds., *The Nonprofit Sector*. Yale University Press. 2004.

Consumers Union publications on nonprofit health conversions:
<http://consumersunion.org/topic/health-care/non-profit-conversion/>

Non-profit conversion

Nonprofit health corporations are unique. While they are created to meet the health needs of a particular community, they are also organized to fulfill broad public purposes. Thus, nonprofits and their boards have obligations to the public and must be responsive and accountable to the people they serve. To reward nonprofit corporations for their public commitment, society provides special treatment and recognition to them, such as government subsidies or the ability to accept tax-deductible donations. After years of research, and active litigation to preserve nonprofit assets for the public purposes for which they were originally granted special status, Consumers Union has become one of the preeminent expert sources of data and advice for communities when a nonprofit hospital or insurance company announces its intention to merge, convert or otherwise become subsumed in a for profit company.

[Click here for a complete listing of our research and legal documentation.](#)

Conversions Overview

Across the country, many nonprofit health organizations such as hospitals, HMOs, and insurance companies have changed and continue to change from nonprofit to for-profit status. These transactions are called “conversions.” [Consumers Union’s Model Conversion Act \(PDF\)](#) defines a “conversion transaction” as occurring when there has been a substantial change in a nonprofit’s mission, or the sale, transfer, lease, exchange, transfer by exercise of an option, optioning, conveyance, conversion, merger, affiliation, mutualization, joint venture or other disposition resulting in the transfer of control or governance of 10% or more of the assets or operations of a nonprofit or \$5 million, whichever is less.

Under federal law and almost all state laws, the assets of nonprofit organizations must be permanently dedicated to charitable purposes. When a nonprofit converts to for-profit status, it will no longer be organized to serve such purposes and instead will be dedicated to maximizing profits. Accordingly, a converting nonprofit must transfer the full value of its assets to another nonprofit organization that will serve similar charitable purposes. Essentially, as an organization crosses the border between the nonprofit and for-profit sectors, the law requires that nonprofit charitable assets must continue to be channeled into public benefits and not fall into private hands.

Conversions take on many forms and include outright sales of facility and other assets (or a portion of them), transfers of leases, joint ventures, mergers, affiliations, acquisitions, the creation of for-profit subsidiaries and holding companies, or other deals that effectively change the mission of the nonprofit or transform it into a for-profit corporation.

At stake in these conversions are two extremely important community health resources:

Health services such as indigent care, emergency room coverage, and other health services that are critical for maintaining healthy communities.

Access to these crucial health services is at stake when a community's nonprofit hospital or health plan changes to for-profit. Key questions that advocates should consider are: Which health services will the new for-profit prioritize? Which services will the for-profit continue or expand? Which services will the for-profit reduce or eliminate? What will happen if the for-profit corporation sells, merges, or transfers to new owners? What happens if the for-profit becomes insolvent or closes its doors? What impact will a conversion have on the quality, accessibility, and affordability of health care in a community?

Nonprofit assets that have been built by and on behalf of the public are also at risk when any nonprofit health corporation proposes to convert.

Communities should demand that a nonprofit corporation answer many questions during the review of a transaction to ensure its public assets are protected. The questions include: What is the value of those assets? Will the conversion preserve the assets for nonprofit purposes or will the assets go to the for-profit company for private individuals to reap windfalls? How should the charitable organization that receives the assets be structured to ensure that it is independent from the converting corporation and concerned only with working for a healthy community?

Nonprofit Health Sector: History and Trends

The greatest nonprofit conversion activity to date has been in the health care industry. No other group of nonprofits has experienced such a dramatic shift in resources from nonprofits to for-profits. When the trend first began, regulators were often unwilling or unable to become involved in the conversion transaction. Without strong oversight, the early years of health care conversion activity resulted in the loss of millions of community dollars and vast health resources to the for-profit sector. Many of those dollars ended up in the hands of former executives, board members, and employees of the nonprofit as well as private investors. Rarely were the transactions and documents made public.

In the late 1980s and early 1990s, after watching their communities lose millions of dollars that should have been earmarked to further the nonprofit mission, a handful of regulators and consumers gradually joined the conversion debate. Several states passed health care conversion legislation to protect the public's interest in conversions. The first conversion transaction to capture national attention was Blue Cross of California's attempt to transfer its nonprofit assets to a for-profit subsidiary without preserving those assets for the public's benefit. As community members learned about the transaction, they formed a coalition and called on regulators to prohibit the conversion unless community assets were protected. The California controversy lasted more than three years. Although initially the nonprofit board of directors and its executives denied their public obligations, by the time regulators signed off on the transaction (PDF) in 1996, more than \$3 billion in nonprofit assets had been set aside in two charitable foundations dedicated to health care. The community groups' efforts paid huge dividends. Today, these two foundations together make over \$200 million in grants each year to improve access to quality health care for Californians.

At the request of Blue Cross of California, the National Blue Cross Blue Shield Association changed its by-laws to allow its members to become for-profit health insurance companies. This had a domino effect on other Blue Cross and Blue Shield plans. Soon after Blue Cross of California proposed its conversion, health plans in Missouri, Colorado, Georgia, and Virginia sought to convert. In some of

those transactions, state regulators and the community succeeded in enacting legislation or improving requirements to preserve the assets for the public's benefit.

But lawmakers and advocates in other states were not so fortunate. In Georgia, for example, Blue Cross and Blue Shield lobbyists convinced the state legislature to permit the nonprofit health plan to convert to a for-profit business without leaving any assets for the community. It took three years and a lawsuit before the community was able to unravel the damage caused by that legislation. Again, the battle was worth it—an \$80 million nonprofit health foundation was created in Georgia.

Legal Context

Proceedings regarding conversions within the health industry require the making of policy decisions that can have a widespread impact. For this reason it is important that the decision makers take the community perspective into consideration when they act. Communities and consumers essentially own the assets of nonprofits involved in conversion. The law recognizes and protects the public's investments in these nonprofits, requiring that the assets remain committed to the public good. Also, the statutes that govern these proceedings often provide for some form of public participation. Such statutory provisions vary from simple public notice requirements or mandatory public hearings to the granting of full party status and providing funding to encourage the participation of consumer groups. Laws that facilitate the participation of consumer groups ensure that agency proceedings result in sound policy development, foster consumer involvement and guarantee that the important work of protecting consumers and the marketplace can continue.

Recognizing a Conversion

A conversion occurs when a nonprofit corporation transfers some or all of the control of its nonprofit assets to a for-profit corporation or to another nonprofit with a different purpose and mission. See the [Consumers Union's Model Conversion Act \(PDF\)](#) for more essential definitions. A health corporation's assets can include everything from its building, furniture and equipment to its trademarks and patient lists. Conversion transactions include sales or leases of assets, joint ventures, mergers, affiliations, acquisitions, mutualizations, the formation of for-profit subsidiaries and holding companies, or other deals that effectively transform the nonprofit into a for-profit corporation. In these transactions, which are explained in the sections below, assets are changed from nonprofit to for-profit purposes.